Sumitomo Mitsui Financial Group Inc. (SMFG)

Updated June 6th, 2021 by Josh Arnold

Key Metrics

Current Price:	$7.39	**5 Year CAGR Estimate:**	2.7%	**Market Cap:**	$51 B
Fair Value Price:	$6.40	**5 Year Growth Estimate:**	1.0%	**Ex-Dividend Date:**	09/28/21[1]
% Fair Value:	116%	**5 Year Valuation Multiple Estimate:**	-2.9%	**Dividend Payment Date:**	12/10/21
Dividend Yield:	4.6%	**5 Year Price Target**	$6.70	**Years Of Dividend Growth:**	0
Dividend Risk Score:	D	**Retirement Suitability Score:**	C	**Last Dividend Increase:**	N/A

Overview & Current Events

Sumitomo provides commercial banking, leasing, securities, consumer finance, and related activities, primarily in Japan. The company has four segments: Wholesale Business, Retail Business, International Business, and Global Markets. The Wholesale Business segment offers financing, investment management, risk hedging, M&A advisory, leasing services, and more to commercial clients. The Retail Business offers wealth management, settlement, consumer finance, housing loans, and related services to consumers. The International Business segment offers loans, deposits, trade finance, project finance, derivatives, cash management services, underwriting services, leases, and more to commercial customers. Finally, the Global Markets Business offers forex products, bonds, stocks, derivatives, and related products and services to commercial customers globally. Sumitomo was founded in 2002 and is headquartered in Tokyo. Sumitomo employs just over 86,000 people, and we note that the company's fiscal year ends in March. Sumitomo trades in Japan, but US-based investors can own ADRs via the SMFG ticker. The stock trades in the US with a market capitalization of $51 billion, and the company should generate about $13 billion in revenue this year. Note that Sumitomo reports results in Japanese Yen, but all figures have been converted to USD.

Sumitomo reported full-year earnings on May 14th, 2021, and results were somewhat mixed. Net adjusted profit declined fractionally year-over-year to $9.9 billion, driven by a decrease in equity in gains of affiliates due to an increase in credit costs, but partially offset by an increase in gross profit from strong wealth management and securities gains.

Total credit cost was more than double what it was in the prior year, due to incurring credit costs from the spread of COVID-19, as well as precautionary provisions recorded in order to prepare for possible future losses. Our take is that Sumitomo is likely over-provisioned at this point, meaning there could be some unwinding that would support profits in the coming quarters. Given this, ordinary profit declined from $8.5 billion to $6.5 billion. In addition, Sumitomo took charges against impairment losses of Sumitomo Mitsui DS Asset Management Company, driving another $1.8 billion out of profits. Total assets were $2.2 trillion at the end of the year, up about 10% from the prior year. Total deposits ended the year at $1.3 trillion, while total loans were just $777 billion.

We expect earnings-per-share to be roughly equal to last year given the company seems over-provisioned for credit losses, and because the recovery from COVID-19 is well underway. We note that results can be quite volatile, however, so we'll reassess after Q1 results.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	$0.81	$0.86	$1.09	$0.86	$0.94	$0.65	$0.83	$0.63	$0.29	$0.58	***$0.58***	***$0.61***
DPS	$0.24	$0.23	$0.23	$0.23	$0.27	$0.27	$0.32	$0.32	$0.35	$0.34	***$0.34***	***$0.36***
Shares[2]	6929	6772	6835	6841	6841	6852	7058	6993	6880	6855	***6850***	***6800***

Sumitomo's earnings growth has been choppy to say the least over the years. The company produced a high of $1.09 in earnings-per-share in 2014, but hasn't come anywhere close to that in subsequent years. We see the company's growth

[1] Estimated date
[2] Share count in millions
Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

at 1% annually over the next five years but note that we think it will continue to see large swings in both directions given the volatile nature of its diverse business lines. Sumitomo has massive scale in Japan, being the country's second-largest bank, and Sumitomo is a huge payments provider in that country. Still, management is somewhat pessimistic on credit quality at this point, and we think earnings will struggle to move meaningfully higher.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	7.9	10.6	7.6	9.4	6.9	11.9	9.9	11.2	20.5	11.9	***12.7***	***11.0***
Avg. Yld.	3.8%	2.6%	2.8%	2.9%	4.1%	3.5%	3.9%	4.6%	6.0%	4.9%	***4.6%***	***5.3%***

Sumitomo's valuation has moved erratically over the years, as one would expect given the movement in earnings. We assess fair value at 11 times earnings, but shares trade today at 12.7. We therefore see a headwind to total returns from the valuation but note that the dividend is quite attractive at 4.6%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	30%	27%	21%	27%	28%	41%	39%	51%	124%	59%	***59%***	***59%***

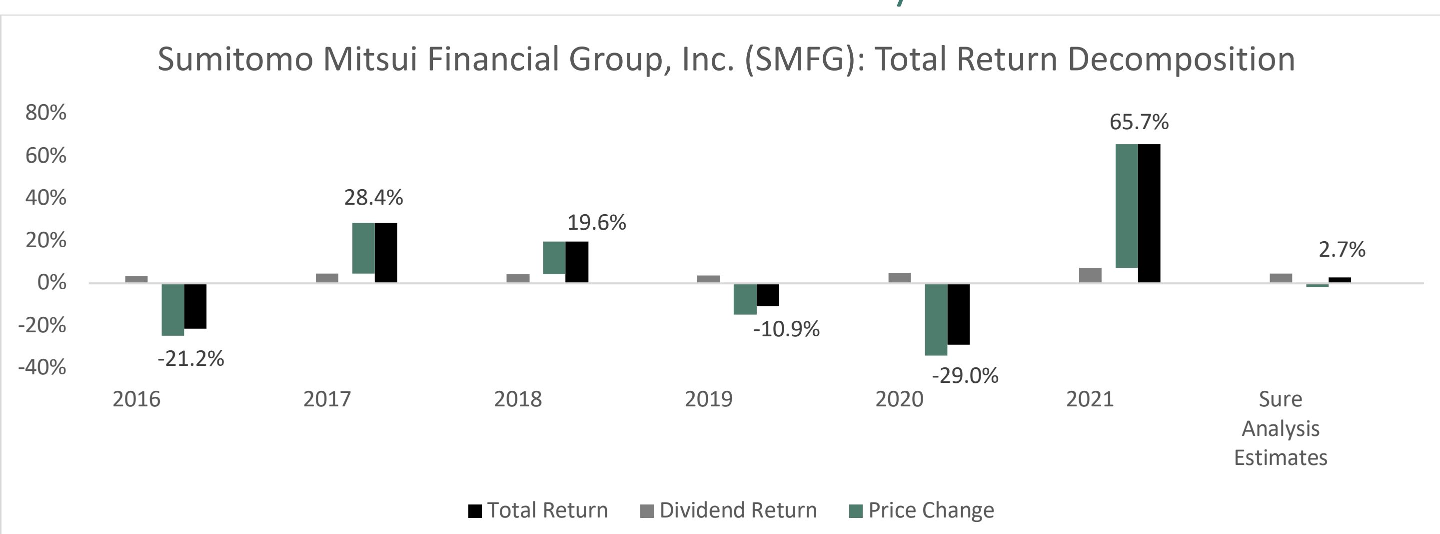
The payout ratio has moved up and down with earnings over the years, but we see the current dividend as sustainable. Sumitomo is unlikely to be a dividend growth story, however, given its unpredictable earnings.

Sumitomo sports advantages of scale in Japan with its $2+ trillion balance sheet, but otherwise, it provides substantially the same services as other financial companies. Recessions won't be kind to Sumitomo, either, as banks are beholden to economic strength for credit quality, which is something Sumitomo is still dealing with more than a year after the pandemic began.

Final Thoughts & Recommendation

Sumitomo has rallied strongly in the first half of 2021, with investors bidding up financial stocks on perceived upward momentum of interest rates. However, the stock looks expensive to us today, and while the yield is high on an absolute basis at 4.6%, that's low in the three-year range for Sumitomo. With a modest growth forecast, and a valuation that we see as 16% in excess of fair value, we're initiating Sumitomo with a sell rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	33,191	32,222	30,544	28,346	29,108	28,690	31,323	27,847	24,971	29,871
SG&A Exp.	15,331	15,491	13,572	13,238	12,662	14,519	14,863	13,859	12,563	16,702
D&A Exp.	2,191	2,406	2,187	2,202	2,133	2,789	2,800	1,975	2,917	2,143
Net Profit	4,286	6,486	7,652	5,615	7,056	5,879	6,947	4,995	1,954	4,837
Net Margin	12.9%	20.1%	25.1%	19.8%	24.2%	20.5%	22.2%	17.9%	7.8%	16.2%
Free Cash Flow	13,806	23,949	63,837	64,787	-21,670	28,704	93,188	19,282	78,722	174,243
Income Tax	5,834	3,089	4,134	3,749	3,107	1,292	2,070	1,662	476	1,475

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets ($B)	1,723	1,569	1,541	1,493	1,603	1,710	1,808	1,763	1,963	2,199
Cash & Equiv. ($B)	97.8	125.4	322.7	334.2	383.9	423.3	514.7	521.0	578.0	657.8
Goodwill & Int. Ass.	10,925	9,593	9,287	8,131	9,325	9,808	7,866	7,412	7,731	6,697
Total Liabilities ($B)	1,633	1,478	1,450	1,401	1,505	1,603	1,691	1,657	1,862	2,091
Accounts Payable		21,786	21,537	17,575	20,286	28,456	22,381	13,823	21,732	---
Long-Term Debt ($B)	242.1	203.8	224.6	251.7	213.9	245.3	229.7	238.6	308.8	275.2
Equity ($B)	65.3	68.6	74.7	77.8	84.6	92.9	106.0	101.7	100.6	107.2
D/E Ratio	3.71	2.97	3.01	3.24	2.53	2.64	2.17	2.35	3.07	2.57

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	0.3%	0.4%	0.5%	0.4%	0.5%	0.4%	0.4%	0.3%	0.1%	0.2%
Return on Equity	6.5%	9.7%	10.7%	7.4%	8.7%	6.6%	7.0%	4.8%	1.9%	4.7%
ROIC	1.2%	2.1%	2.5%	1.7%	2.2%	1.8%	2.0%	1.4%	0.5%	1.2%
Shares Out.	6929	6772	6835	6841	6841	6852	7058	6993	6880	6855
Revenue/Share	4.78	4.76	4.47	4.14	4.26	4.19	4.44	3.98	3.63	4.36
FCF/Share	1.99	3.54	9.34	9.47	(3.17)	4.19	13.20	2.76	11.44	25.42

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.